

## ACCOUNTANCY AND AUDIT WITHIN THE NATIONAL EUROPEAN UNION ACCESSION PROGRAM OF THE REPUBLIC OF CROATIA - YEAR 2004

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### Summary

On its session held on 15<sup>th</sup> January 2004, the Government of the Republic of Croatia has promulgated the Republic of Croatia's National EU Accession Program - Year 2004, together with the Republic of Croatia's *Acquis Communautaire* Legislation Harmonization Plan for the Year 2004 – Supplement A to the National Program.

The national program has been directed toward the aggregation of all objectives and tasks of the republic of Croatia in the implementation of the EU – oriented Stabilization and Accession Agreement.

In force in the Republic of Croatia are the Accountancy Act and the Audit Act regulating the spheres of accountancy and audit.

The Government of the Republic of Croatia has enacted the Plan pertaining to the EU's *acquis communautaire*, relating to the strict satisfaction of EU requirements regarding accountancy and audit that are to be regulated by the New Accountancy and Audit Act.

*Key words:* National Program, European Union, *acquis communautaire*, accountancy, audit.

### 1. Prolegomena

The Republic of Croatia's *National EU Accession Program - Year 2003*<sup>1</sup> combines the purpose, tasks and aims of the Republic of Croatia in the implementation of the EU-oriented Stabilization and Accession Agreement; it systematically presents the tasks and the goals respecting the structure of the European Commission's Report. The Program is evidently directed at the fulfillment of the accepted commitments and the making of directives required for the implementation of all necessary reforms on the way of the Republic of Croatia to achieving its strategic goal – accession to the membership in the European Union.

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<sup>1</sup> The Republic of Croatia's National EU Accession Program - Year 2003, Narodne Novine no. 30, Zagreb, 27<sup>th</sup> February 2003.

In this atmosphere, the Republic of Croatia is facing the execution of fundamental reforms of its entire economic and political system – in a scope unprecedented in the country's history so far. The said reform and thorough adjustment to the economic, legal and political standards of the EU, demands individual and collective participation of all individuals and all institutions in Croatia.

To render the realization of these goals possible and realistic, it was necessary to make a *National Program*. This program contains evaluations, directives and tasks aiming at accelerating all of the activities of the Republic of Croatia, so that it may be ready for its full membership in the EU by the end of 2006. It should be mentioned that by making the Program, the Government of the Republic of Croatia said nothing about when it will become full member of the EU. The realization of this goal does not depend, among others, only on our activities and abilities, but primarily on the decisions of the EU and its dynamics and the scope of the expansion process.

In this context, the National Program has been directed towards several areas that are of key importance on Croatia's way of approaching the European Union. These areas are in particular:

- meeting the politically conditioned criteria,
- economic adjustments,
- adjustment of the legislature of the Republic of Croatia,
- strengthening the administrative capacity for the execution of reforms,
- communication strategy of the Republic of Croatia for informing the Croatian public about the advancing of the Republic of Croatia towards European integrations.

The adjustment of the legislature of the Republic of Croatia<sup>2</sup> with the *acquis communautaire* of the European Union in consistence with the Agreement about the Stabilization and Accession provides the legal and institutional framework of particular sections of the *acquis*, and the priorities in the adjustment of the legislatures for the year 2003.

As a result of the above, there is the necessity to consider the definition of the term - *acquis communautaire*.

Croatian Parliament has adopted the national program of the Republic of Croatia for joining the European Union – for the year 2003 (Narodne novine no. 30/03), in which the making of a new Accountancy Act has been envisaged. As a result, the draft of the Accountancy Act is now undergoing the legislative procedure in the Croatian Parliament.

The Government of the Republic of Croatia has made a plan relating to the *acquis* of the European Union, and this applies to the strict compliance with all

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<sup>2</sup> In the same text, it is presented in chapter VI of the National program on pages 1291 to 1367 and in supplement A on pages 1379 to 1438.

requirements of the European Union regarding audit, which will be regulated by the New Audit Act that should be ratified by the Croatian Parliament by the end of 2004.

The new Audit Act will be harmonized with International auditing standards (ISA) and with the provisions of the Eighth Directive (84/253/the EEC) from 10<sup>th</sup> April 1984, based on the article 54(3) (g) referring to **authorization** of the individuals responsible for state audits of accounting papers and documents. It is also necessary to harmonize the Law with the "Green Book" on the state audit from 24<sup>th</sup> July 1996 and with the recommendation ensuring the quality of legal audits 2000/257/EC, Službeni list 91., from 31<sup>st</sup> March 2001.<sup>3</sup>

## 2. Harmonization of Croatian Legislature with the *Acquis Communautaire*

The Government of the Republic of Croatia has already in the beginning of 1999 decided to initiate the process of voluntary evaluation of the coordination of the existing legislature with the *acquis communautaire* of the European Union. This has been done to hasten further steps of the Republic of Croatia in its approaching towards the European Union and also to suggest the future development of the contractual relations. A detailed account of this process was given in the, presented to the European Commission in October 1999. The goals of the Plan of Integration Activities include the following:

- creation of the foundation for a detailed strategy of integration of the Republic of Croatia in the European Union,
- establishment of the framework for defining, coordination and execution of the economic, legal and political activities in the integration process, as well as
- defining of the short-term, medium-term and long-term goals in the sphere of education, improvement and informing.

The White Paper for the preparation of the countries of Central and Eastern Europe for their integration into the internal market of the European Union has served as the basis for evaluation of the coordination of the existing Croatian legislature with the *acquis communautaire*. The analysis of the level of coordination of the legislature of the Republic of Croatia with the *acquis* has been performed on 23 sections of the *acquis* and has determined areas which, at that point, have not been regulated by legislation, such as, for example, subsidies and consumers protection as well as the level of harmonization of existing legislature in other areas. These initial facts have served as the basis for further actions in the process of the adjustment of legislature.<sup>4</sup>

<sup>3</sup> The Republic of Croatia's National EU Accession Program - Year 2004, Narodne novine no.37/2004, Zagreb, 23<sup>rd</sup> March 2004

<sup>4</sup> For more about this, see pp. 1291 to 1293 in the title from footnote 1.

## 2.1. *Acquis Communautaire* of the EU

To understand the largest part of the National Program – more than 70 % of the text – relating to the harmonization of the legislation of the Republic of Croatia with the *acquis communautaire of the EU*, one must start from the definition of that term, which has not been given in the National Program.

*Acquis communautaire of the EU* is a French term – “it is also called the legacy of the Community – refers to a set of rights and obligations binding and connecting all member states within the European Union. It is not only law in the narrower sense of the term, because it also includes: contents, principles and political goals of inaugural contracts, legislature adopted through the implementation of inaugural contracts and verdicts passed by the European Community’s Court of Justice, declarations and resolutions adopted by the Union, measures relating to the Common Foreign and Security Policy, measures relating to the administration of justice and internal affairs, and international conventions and treaties in the sphere of activity of the Union. Every state intending to join the European Union must accept the decisions from inaugural contracts and harmonize its legislature with the *acquis communautaire*.”<sup>5</sup>

These are, therefore, legal acquirements of the Community. According to the estimation of the European Commission, in 2001, for example, these legal acquirements of the EU included more than 80,000 pages of documents. And this number is augmented by approximately 2,500 pages every year. Therefore a procedure was initiated, aiming at a significant simplification of the legal regulations of the EU and its reduction to about 32,000 to 35,000 pages. In this connection, Croatian legislature now needs to be harmonized with this huge quantity of the EU’s legal acquirements.

This adjustment will take place over a transition period of 6 years starting from the date on which the Agreement about the Stabilization and Accession to the EU is signed. The process will go on gradually in stages, so that in the first phase, among other issues, Croatia needs to regulate the legal problem area relating to entrepreneurs (companies) and to accountancy and, of course, auditing connected with them.

## **3. Institutional Accounting Framework as a Part of the Republic of Croatia’s National Program for Accession to the European Union**

### 3.1. The Accountancy Act

In the Republic of Croatia, accounting information system or accountancy is regulated by the Accountancy Act.<sup>6</sup> This is the basic act regulating the said field. In addition to it, there are other acts regulating the accounting of banks, investment

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<sup>5</sup> Short Lexicon of European integrations, Ministry of European Integrations, 2001, p. 3.

<sup>6</sup> Accountancy Act, Narodne novine no. 90, Zagreb, Wednesday 30<sup>th</sup> December 1992.

funds, insurance and reinsurance companies, pension funds, non-profit organizations and budgets.

Primarily, Accountancy Act starts from the entrepreneur. Consequently, every entrepreneur whose headquarters are in the Republic of Croatia is obliged to keep his accounting books and submit financial accounting reports according to the basic principles of orderly bookkeeping, so that these books give clear accounts of his business operations and of the state of his property.

The basic structure of the Accounting Act includes:<sup>7</sup>

- basic provisions,
- data collection, data processing and book-keeping documents,
- business books,
- property list and list of obligations,
- basic financial reports,
- accounting standards,
- classification of entrepreneurs,
- contents of financial reports
- evaluation principles,
- annual report
- financial reports audit,
- announcement of financial reports
- presentation of financial statements and annual report
- language and currency unit,
- penal provisions (measures),
- transitional and final provisions

We should also point out the *fundamental characteristics of the Accountancy Act*, and they are the following:

- the Croatian Accounting Information System, i.e. accountancy - especially of entrepreneurs – is based on the *International Accounting Standards (IAS)* set up by the International Accounting Standards Committee (IASC). This Committee seized to exist on 1<sup>st</sup> April 2001, and was replaced by a new body which has renamed the International Accounting Standards into *International Standards of Financial Reporting*.<sup>8</sup> The implementation of the International Accounting Standards is also suggested in the following text: “In the Republic of Croatia, International Accounting Standards are applied; these standards are published in “Narodne novine”.”<sup>9</sup>

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<sup>7</sup> Ibidem

<sup>8</sup> The original name of the these standards is International Financial Reporting Standards (IFRS).

<sup>9</sup> The Title quoted in footnote 5, Art. 15, p. 2135

Hence, *entrepreneurs in the Republic of Croatia directly apply International Accounting Standards in writing financial accounting reports.*

Aside from this: “Before any explanation or consideration of the International Accounting Standards, the following should be especially emphasized:

- producers and users of financial reports must especially consider and acquire knowledge about accounting principles, i.e. about the Framework for the composition and presentation of financial reports.

- according to their characteristics, International Accounting Standards are not above the law, however, it is not possible to avoid their implementation and the Accounting Act regulations have practically arranged them as parts of law

- International Accounting Standards have been intended for external financial reporting

- external financial reporting is always the responsibility of the administration or the individual in the position of the president of the board, but the competence and ability of the accountant will considerably eliminate numerous conflicts with the laws, or non-implementation of the International Accounting Standards

- in recent times, there is the obligation to give additional explanations, i.e. to elaborate the official viewpoints of the Standing Committee in the explanations of the International Accounting Standards

- certain additional explanations and concrete examples also are also bound by the attitudes of the Croatian Board for Accounting and Accounting Standards (for example accompanying the IAS 1, 14, 34, 29)

- financial reports are fully valid when they are verified by an authorized auditor, which also requires the auditor to acquire additional knowledge and skills, especially about the making of new International Accounting Standards and the implementation of the already existing ones

- finally – although perhaps it should have been mentioned as first – there is the ethics of the accountants, auditors and other persons connected with financial reports and other information. Moreover, the Croatian Accountants’ Society was the one that has issued the IFAC’s Code of Ethics for Professional Accountants in 2002, and this Code has been made obligatory according to the work regulations of the Croatian Board for Accounting and Accounting Standards (NN 39/94).<sup>10</sup>

- Croatian Board for Accounting and Accounting Standards has been established and it is authorized to monitor, adjust and explain the use of International Accounting Standards.

- balance scheme and profit and loss account, have been, chiefly, adopted from the Fourth Directive of the EU, which allows two forms of balances and four forms of profit and loss accounts.

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<sup>10</sup> The title quoted in footnote 1, p. 1322.

- the account plan has not been formally regulated by the Accounting Act. However, in his account plan, the entrepreneur is obliged to provide data and accounting information according to the prescribed positions in the balances and profit and loss accounts.

### 3.2. Institutional Framework for Other Types of Accounting

In addition to the provisions of the Accounting Act, there are also some other laws regulating specific forms of accounting. These specific forms include the accounting of:

- banks,
- investment funds,
- pension funds,
- non-profit organizations.<sup>11</sup>

*Accounting of banks*, for example, under the Bank Act (NN 84/02), provisions of articles 101-105 regulate the accounting of banks. Further, the provisions of particular articles of the Company Law (NN 111/93, 34/99 and 52/00) regulate the keeping business books and book-keeping documents, i.e. the company's documents after the company ceases to exist.

*Accounting of investment funds*, provisions of articles 5 and 6 of the Investment Funds Act (NN 107/95, 12/96 and 114/019) regulate the issues of periodical monetary accounting reports (half-yearly and yearly) of the investment funds. On the other hand, the Book of regulations about the accountancy registering and about the financial reports of the societies for the management of funds and investment funds (NN 28/99) prescribes the institutional framework for accountancy registering, the obligation to write reports, and the contents of the financial reports of the societies for the management: of funds, closed and open investment funds and privatization investment funds.

*Accounting of pension funds*, provisions of Article 59 of the Compulsory and Voluntary Pension Funds Act (NN 44/99 and 63/00) prescribe that the bookkeeping and accounting of pension companies must be with the International Accounting Standards, whereas the provisions of Articles 88-90 regulate the duty to prepare reports and communicate information about the obligations of pension funds. Among others, there is also the regulation prescribing the duty to deliver financial reports to the Central Registry of Insured Persons and to the Pension Funds and Insurance Surveillance Agency. As for the keeping of account books, deadlines and contents of financial reports of pension companies, of obligatory and of voluntary pension funds – these are regulated by the Book of Regulations about Accounting and about Financial Reports of pension companies and pension funds (NN 115/01).

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<sup>11</sup> Ibidem

*Accounting of non-profit organizations*, is regulated by the By-Laws about the Accounting of Non-Profit Organizations (NN 112/93), which covers especially data collection and processing, book-keeping documents, basic financial reports and other areas in connection with the accounting of non-profit organizations. Provisions of this Regulation relate primarily, to institutions, state authority bodies, units of local self-government and government and their bodies, religious and other legal persons that – according to the law – are classified as non-profit organizations. Management of accounting (business) books and composition of book-keeping documents, organization of bookkeeping, rights and duties of authorized documents, listing of property and obligations, evaluation principles, reevaluation and correction of financial reports, accounting plan, fund accounting, value correction rates of lasting property and other issues in connection with the accounting of non-profit organizations and with the execution of the Regulation about the accounting of non-profit organizations have been regulated by the Book of regulations about the bookkeeping and the accounting plan of non-profit organizations (NN 20/94 and 40/94).

### 3.3. World Bank Report about the Croatian Accounting and Audit Systems

The World Bank has issued its Report about the Croatian accounting and audit system, in which it especially emphasizes that the quality of the financial reports of many Croatian companies is good and that there are no significant deviations in the sense of non-application of the International Accounting Standards in the preparation of the mentioned reports. This is, actually, the most important and the greatest possible praise, and it can therefore be expected that Croatia and its accounting system will serve as the role model for other, not only transitional countries.

Beside this, following the provisions of the Accountancy Act, the Croatian Board for Accounting and Accounting Standards has been established. However, it has been concluded that it is especially necessary to strengthen the control of the practical implementation of the International Accounting Standards. Enforcement or monitoring of the compliance with the International Accounting Standards was particularly strongly emphasized by the World Bank. As a result, this issue must be dealt with institutionally.

## **4. Standardization of Accounting Reporting in the European Union**

The Accounting and Financial Reporting System in the European Union is also in the process of improvement and promotion of new solutions. It must be especially emphasized that all those companies, whose shares are traded with, and whose headquarters are in any of the EU countries, will be obliged to apply International Accounting Standards starting from 1<sup>st</sup> January 2005, i.e. they will have to apply International Standards of Financial Reporting – as they are now called.



Furthermore, the directives of the EU relating to small and medium size entrepreneurs have also been significantly adjusted with the directives of the International Accounting Standards.

The understanding of the accounting information system, i.e. of the accounting based on the International Accounting Standards, requires the knowledge of the basics of accounting and of its use in concrete situations.

For better understanding of the accounting system, this provides guidance for the use of the International Accounting Standards, simplifying their implementation in drawing up external financial and accounting reports.

In this context, *it is necessary to understand the accounting and financial reporting system based on the International Accounting Standards, i.e. on International Standards of Financial Reporting.*

## 5. Conclusion

The accounting institutional framework in the sphere of the National Program of the Republic of Croatia for the Accession to the European Union in which achievements, states and tasks regarding the harmonization of the Croatian accounting legislature with the *acquis communautaire of the EU* is being considered, leads to the conclusion that *it is necessary to compare the state of our and of the European accounting acquirements.*

Under such circumstances, the conclusion of the National program about the priorities is very important; it says: The Accounting Act will have to be re-written according to the most recent requirements of the EU law in the area of accounting. Here, we must keep in mind the recommendations of the World Bank and the expected role of the Republic of Croatia.

## Literature:

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